



United States  
General Accounting Office  
Washington, D.C. 20548

General Government Division

B-257608

June 16, 1994

The Honorable Jim Sasser  
Chairman, Committee on  
the Budget  
United States Senate

Dear Mr. Chairman:

By letter dated June 14, 1994, you referred to the additional budget authority being requested for fiscal year 1995 Internal Revenue Service (IRS) compliance initiatives and asked for our opinion on the effect of the additional authority on budget deficits over the next 5 years.

We believe that the additional budget authority will not increase the budget deficit over the 5-year period in question provided (1) the funds are used as intended to increase IRS' enforcement staffing levels and thus generate more revenues through enhanced compliance efforts, (2) funds are provided in the fiscal years after 1995 to maintain the increased staffing levels, and (3) IRS is able to successfully hire, train, and retain the additional staff provided by the budget authority. A deficit increase in the first year is possible because of the lag between the time new staff are hired and the time they become productive. In our opinion, however, based on past reviews of IRS' enforcement programs, an increase in enforcement staffing will help generate significant revenues over the long term, provided the increased staffing levels are maintained. IRS' enforcement presence is relatively low (e.g., IRS now audits less than 1 percent of the total number of income tax returns filed) and yet revenues to be collected are substantial--the estimated income tax gap for tax year 1992 was \$127 billion. Last month, we issued a report on the tax gap in which, among other things, we discussed efforts toward and ideas for reducing the gap, including the possibility of providing IRS with additional enforcement resources.<sup>1</sup>

---

<sup>1</sup>Tax Gap: Many Actions Taken But a Cohesive Compliance Strategy Needed (GAO/GGD-94-123, May 11, 1994).

We are taking a position on the budget authority's impact on budget deficits even though it is not yet certain how IRS intends to allocate the additional funding among its various enforcement programs. Earlier this year, as shown in the enclosures, IRS had prepared an allocation and a corresponding estimate of revenue return on the investment of about \$9.2 billion over 5 years. However, IRS premised its allocation and estimate on the assumption that (1) total funding for the compliance initiatives would amount to \$2.5 billion over 5 years and (2) that level of funding would support 5,078 full-time equivalents (FTE) in fiscal year 1995 and 8,136 FTEs in succeeding years.<sup>2</sup> The Senate budget resolution, however, limits funding in any 1 year to no more than \$405 million. This amount is the same as the cost presented in the President's budget--\$405 million a year, or \$2.025 billion over 5 years.

IRS is revising its staffing allocation and revenue estimate to reflect the funding level in the budget resolution. The kinds of changes being considered, as we understand them, would not alter our opinion as to the impact of the additional budget authority on budget deficits. One of the changes being considered, for example, is consistent with our past recommendation that IRS put more emphasis on telephone contacts in trying to collect delinquent taxes.<sup>3</sup>

Our past work on earlier IRS compliance initiatives, which was done for your Committee, raised two basic concerns that warrant repeating: (1) the initiatives were not implemented as Congress intended and (2) IRS' revenue estimates were unreliable.<sup>4</sup>

---

<sup>2</sup>The number of FTEs in 1995 differs from succeeding years because staff hired to fill many of the new positions would only be on board for part of fiscal year 1995. Thus the number of FTEs in that year would be less than in succeeding years when all staff would be working a full year.

<sup>3</sup>Tax Administration: New Delinquent Tax Collection Methods for IRS (GAO/GGD-93-67, May 11, 1993).

<sup>4</sup>Tax Administration: IRS' Implementation of the 1987 Revenue Initiative (GAO/GGD-88-16, Dec. 2, 1987); Tax Administration: Difficulties in Accurately Estimating Tax Examination Yield (GAO/GGD-88-119, Aug. 8, 1988); Tax Administration: Potential Audit Revenues Lost While Training New Revenue Agents (GAO/GGD-90-77, Apr. 6, 1990); Tax Administration: IRS Needs More Reliable Information on Enforcement Revenues (GAO/GGD-90-85, June 20, 1990); and Tax Administration: IRS' Improved Estimates of Tax Examination Yield Need to Be Refined (GAO/GGD-90-119, Sept. 5, 1990).

As summarized in our recent report on IRS' budget request for fiscal year 1995, IRS' inability to deliver past compliance initiatives resulted, in large part, from shortfalls (i.e., unfunded costs) that caused IRS to reprogram to other activities funds appropriated for the compliance initiatives.<sup>5</sup> Some of the shortfalls were because of circumstances, such as unfunded pay raises, that were beyond IRS' control, while others stemmed from IRS' problems in accurately estimating labor costs.

IRS is facing another shortfall in fiscal year 1995 due to several assumptions embodied in its budget request. First, according to IRS budget officials, the Department of the Treasury required IRS to use a non-pay inflation factor that is less than the rate applied to other agencies. As a result, those officials expect IRS' support cost budget to be short. Second, IRS' budget is to be decreased to reflect its share of government-wide procurement savings that were proposed by the President as a result of work by the National Policy Review. IRS budget officials told us that those savings will be difficult to realize. Third, the President's budget, and thus IRS', assumes a 1.6 percent federal workers' pay raise for fiscal year 1995. The actual pay raise may be more. Fourth, IRS' budget assumes productivity savings associated with various systems being implemented as part of Tax Systems Modernization. Realization of those savings could be jeopardized if IRS' appropriation for Tax Systems Modernization is reduced as called for in the appropriation bill being considered by the House of Representatives. Using data provided by IRS budget officials, these factors together could result in a shortfall of between \$100 and \$200 million.

Such a shortfall could erode IRS' ability to adequately fund its base enforcement operations and could, as in the past, result in some of the compliance initiative money being used to bring IRS back to the level it was before the erosion. To the extent that happens, the effect of the compliance initiatives on IRS' overall enforcement presence will be diminished. Even under those circumstances, however, we believe that funding of the initiatives will result in more revenue than they cost with the stipulations mentioned earlier.

In past reports to your Committee, we documented various deficiencies with IRS' methodologies for estimating the amount of additional revenue the government could expect to realize as a result of past compliance initiatives. Because of those deficiencies, we questioned the reliability of IRS' estimates.

---


<sup>5</sup>Tax Administration: Analysis of IRS' Budget Request for Fiscal Year 1995 (GAO/GGD-94-129, Apr. 20, 1994).

IRS has since changed its methodology for estimating the additional revenues to be generated by augmenting its Examination function. Although we have not done an in-depth review of that methodology or the estimates generated thereby, information we have reviewed indicates that IRS' changes addressed most of the problems we identified with the earlier methodology. Thus, we are more confident than in the past about the reliability of the revenue estimates associated with the Examination part of the compliance initiatives.

IRS has said that the revenue estimating methodologies for its Collection and Information Returns programs have also been improved, but we have not done any work that would enable us to comment on the nature or adequacy of those changes.

- - - - -  
I trust this information is responsive to your request. If you have any questions or if we can be of any more help, please call me at 512-5407.

Sincerely yours,



Jennie S. Stathis  
Director, Tax Policy and  
Administration Issues

Enclosures

(268652)

INTERNAL REVENUE SERVICE  
COMPLIANCE PROPOSALS  
[\$ in Millions]

RESOURCES	REVENUE RETURN (\$ Millions)					TOTAL '95-'99
	FY 1995	FY 1996	FY 1997	FY 1998	FY 1999	

TAX LAW ENFORCEMENT

Increase Number of Tax Returns Examined:

	FTE	\$ MIL.								
Field Audits (Revenue Agents)	1,582	\$119								
Office Audits (Tax Auditors)	633	40	(\$43)	\$11	\$176	\$257	\$364	\$764		
Service Center Correspondence Audits	479	27	13	107	264	365	393	1,141		
Collection of Delinquent Taxes	1,222	77	71	204	284	319	354	1,232		
More Effective Use of Information Reporting Documents to Tax Unreported Income	703	54	191	542	823	912	912	3,380		
SUBTOTAL, TAX ENFORCEMENT	4,619	\$317	102	417	672	688	691	2,670		
			\$333	\$1,281	\$2,218	\$2,540	\$2,713	\$9,086		

INTERNATIONAL ENFORCEMENT

International Examinations	90	\$9								
Chief Counsel -- Large Case Initiative	40	5	(\$2)	\$3	\$21	\$25	\$46	\$93		
SUBTOTAL, INTERNATIONAL	130	\$14	0	0	0	0	0	0		
			(\$2)	\$3	\$21	\$25	\$46	\$93		

CRIMINAL ENFORCEMENT

Fraud Investigations	231	\$56								
Motor Fuel Excise Tax	98	18								
SUBTOTAL, CRIMINAL ENFORCEMENT	329	\$74								

TOTAL COMPLIANCE PROPOSALS	5,078	\$405	\$331	\$1,284	\$2,240	\$2,565	\$2,759	\$9,179		
----------------------------	-------	-------	-------	---------	---------	---------	---------	---------	--	--

## FY 1995 TAX GAP INITIATIVES

(In Thousands of Dollars Collected)

	<u>FY 95</u>	<u>FY 96</u>	<u>FY 97</u>	<u>FY 98</u>	<u>FY 99</u>	<u>Outyears</u>	<u>TOTAL</u>	<u>Yield Per FTE</u>
<b><u>COLLECTION</u></b>								
COLLECTION FTE	1,075	1,791	1,791	1,791	1,791		8,239	
FOLLOW -ON FTE	147	245	245	245	245		1,127	
TOTAL FTE	1,222	2,036	2,036	2,036	2,036		9,366	
REVENUE	\$191,147	\$542,064	\$823,380	\$911,564	\$911,564		\$3,378,718	\$361
<b><u>EXAMINATION</u></b>								
<b>REVENUE AGENT</b>								
EXAM FTE	1,145	1,832	1,832	1,832	1,832		8,473	
FOLLOW -ON FTE	437	699	699	699	699		3,234	
REVENUE	(\$43,200)	\$10,800	\$178,000	\$258,800	\$383,800	\$830,400	\$1,594,200	\$198
<b>TAX AUDITOR</b>								
EXAM FTE	458	733	733	733	733		3,390	
FOLLOW -ON FTE	175	280	280	280	280		1,295	
REVENUE	\$12,700	\$108,800	\$283,800	\$364,500	\$392,800	\$554,800	\$1,898,200	\$362
<b>TAX EXAMINER</b>								
EXAM FTE	347	555	555	555	555		2,587	
FOLLOW -ON FTE	132	211	211	211	211		978	
REVENUE	\$71,200	\$204,200	\$283,800	\$319,200	\$354,100	\$499,800	\$1,731,800	\$468
<b>INTERNATIONAL EXAMINATION</b>								
EXAM FTE	70	92	92	92	92		438	
FOLLOW -ON FTE	20	26	26	26	26		123	
REVENUE	(\$2,400)	\$3,200	\$21,200	\$24,800	\$46,000	\$157,200	\$250,100	\$444
TOTAL EXAMINATION FTE	2,020	3,212	3,212	3,212	3,212		14,868	
TOTAL FOLLOW -ON FTE	764	1,217	1,217	1,217	1,217		5,831	
TOTAL FTE	2,784	4,429	4,429	4,429	4,429		20,499	
TOTAL EXAMINATION REVENUE	\$38,300	\$324,800	\$744,800	\$985,200	\$1,158,700	\$2,041,800	\$5,271,400	\$257
<b><u>Information Returns Processing</u></b>								
<b>UNMATCHABLE R FOLLOWUP</b>								
IRP FTE	200	200	200	200	200		1,000	
FOLLOW -ON FTE	18	18	18	18	18		82	
REVENUE	\$81,100	\$184,500	\$218,000	\$234,500	\$237,800	\$118,800	\$1,054,900	\$978
<b>CORR EXAM/SFR/K-1 PROCESSING</b>								
IRP FTE	250	700	800	800	800		3,350	
FOLLOW -ON FTE	20	57	65	55	65		273	
REVENUE	\$20,494	\$252,858	\$453,800	\$453,800	\$453,800		\$1,833,952	\$431
<b>VOLUNTARY COMPLIANCE</b>								
IRP FTE	200	140	40	40	40		460	
FOLLOW -ON FTE	16	11	3	3	3		38	
REVENUE				N/A				
TOTAL IRP FTE	650	1,040	1,040	1,040	1,040		4,810	
TOTAL FOLLOW -ON FTE	53	85	85	85	85		392	
TOTAL FTE	703	1,125	1,125	1,125	1,125		5,202	
TOTAL IRP REVENUE	\$101,594	\$417,158	\$871,800	\$888,100	\$691,200	\$118,800	\$2,884,452	\$571
<b><u>TOTALS</u></b>								
FUNCTIONAL FTE	3,745	8,043	8,043	8,043	8,043		27,917	
FOLLOW -ON FTE	984	1,507	1,507	1,507	1,507		6,984	
OTHER FTE *	369	588	588	588	588		2,713	
TOTAL FTE	5,078	8,138	8,138	8,138	8,138		37,824	
REVENUE	\$331,041	\$1,284,022	\$2,239,580	\$2,564,864	\$2,759,464	\$2,180,600	\$11,338,571	\$330

\* Other FTE includes Criminal Investigation Initiative (329 FTE/525 positions) and Chief Counsel International (40 FTE/60 positions).